

Corporate Governance and the Design of Board of Directors

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AKADEMISK AVHANDLING

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Abstracts

Paper 1: “The Effects of Board Independence on Busy Directors and Firm Value: Evidence from Regulatory Changes in Sweden.” I use an exogenous change to the rules of corporate governance for Swedish firms in 2005 to identify the causal effects of changes in board structure on firm value. The new rules require there to be at least 50 percent independent directors on the boards of large firms. This offers a quasi-experimental setting where I test for the effects of changes to board independence on the market valuation of firms measured by Tobin’s Q. In order to identify the effects of this shock, and alleviate endogeneity issues inherent to corporate governance studies, I use a regression discontinuity design to capture the reaction of the market to the new governance rules, taking advantage of the fact that only large firms are required to comply with the code. The results indicate that (a) the market reacts negatively to the enactment of the new governance rules, and (b) target firms that complied with the independence requirement have a lower Tobin’s Q than non-target firms. I further investigate potential causes behind the estimated negative effect by looking at the busyness of independent directors. The code imposes an increase in the number of independent directors but does not restrict the number of outside directorships they can hold. Thus, an increase in board independence can lead to an increase in board busyness, which can explain the negative reaction from the market. Results indicate that in reaction to the code, target firms have more busy independent directors than non-target firms, and this effect is stronger for target firms that complied with the independence requirement.

Key words: Board independence, independent directors, busy directors, corporate governance, Sweden

JEL classification: G32, G34, G38

Paper 2: “The Value of a Directorship in the Eyes of Busy Directors.” I study the effects of directors’ reputation incentives on their commitment to board duties and assess their impact on the market valuation of firms in Sweden. Using social network theory, I measure the reputation of boards and directors based on their centrality in their respective networks. The more central a firm is relative to other firms in the network, the more reputation incentives it supplies to its directors. First, I look at how the relative reputation of firms can affect directors’ commitment of time and effort. I find that the probability for outside directors to miss board meetings in firms they consider more prestigious is lower than that for directors who consider those firms less prestigious. Second, I aggregate the reputational incentives of directors to the board level, which allows me to measure how directors value their directorships differently. Accordingly, I find that firms with a higher proportion of independent directors who consider them more prestigious witness a significantly better firm valuation than firms with more directors considering them less prestigious. Third, I study the effect of appointing reputable directors to the board in a given year on shareholders’ wealth in subsequent periods. Similar to board network, I measure the talent and reputation of individual directors by relying on their centrality in the overall director network. Directors with high centrality scores are better connected and have better access to information relative to directors who are less central. I find that recruiting reputable directors leads to a better market valuation for firms, and this effect is specific to independent directors. On the other hand, appointing independent directors with low reputation leads to reduced shareholder’s wealth. Finally, I find that using network centrality as a measure of reputation generates statistically stronger results compared with the use of relative firm size.

Key words: Firm reputation, director reputation, social networks, director incentives, independent directors, busy directors, Sweden.

JEL classification: G32, G34, L14

Paper 3: “Investor Protection and the Predictability of Dividends and Returns: A Cross Country Comparison.”

I study return and dividend growth predictability in 59 countries. I find that dividend growth predictability is the dominant form of predictability in small and medium size countries, whereas return predictability is more present in large markets such as the US, the UK and Japan. In order to explain this finding, I investigate if shared corporate governance characteristics across countries can explain this predictive pattern. I measure governance quality using eight indices that capture different aspects of investor protection, the quality of legal systems, and the importance of capital markets (Djankov et al., 2008). Using mean clustering, I classify countries into three portfolios with varying degrees of governance quality. I find that expectations about dividend growth explain most of the variation in dividend yields in countries with low investor protection, whereas return predictability is more dominant in countries with large capital markets and high levels of investor protection. Finally, the quality of the legal system does not seem to be related to one particular form of predictability.

Key words: Dividend yield, predictability, corporate governance quality, investor protection, dividend smoothing, clustering, international stock markets

JEL classification: G12, G15, G34, G38

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